From Managed to Market Capitalism?
German Finance in Transition

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Abstract

Deregulation, technological change, and the integration of markets increase the competitive pressures on forms of national and sectoral governance. The heart of the issue is whether the Continental, consensus-oriented model of capitalism is gravitating toward the Anglo-Saxon, market-oriented model. This essay examines the heuristic value of this convergence thesis, using the German financial sector and its relations to industry and government as a case in point. It will be argued that while institutional restructuring is taking place within Germany that reflects characteristics of Anglo-Saxon capitalism, institutional hurdles, such as federal structures and the veto power of certain societal lobbies, have thus far prevented such a convergence throughout the entire system.

Zusammenfassung

Deregulierungsprozesse, technologischer Wandel und die Integration von Märkten setzen nationale und sektorale Institutionen der Marktkoordination unter Wettbewerbsdruck. Im Kern geht es hierbei um die Frage, ob sich der kontinentale, auf Konsens und Koordination ausgerichtete Kapitalismustyp dem angelsächsischen, eher marktorientierten Typ annähert. Der Beitrag untersucht die Reichweite dieser Konvergenzthese am Beispiel des deutschen Finanzsektors, seiner Beziehungen zur Industrie und zum Staat. Es wird argumentiert, daß im deutschen Modell ein institutioneller Umbau stattfindet, der Charakterzüge des angelsächsischen Kapitalismus in sich trägt. Gleichwohl verhindern institutionelle Bremsen wie föderale Strukturen und Vetopositionen gesellschaftlicher Lobbygruppen bislang eine systemweite Konvergenz.

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Variations of Capitalism between Divergence and Convergence

In the past decade, the managed capitalism thriving in the Federal Republic of Germany has been under an unprecedented pressure to change. The integration of global and European markets, the unleashing of capitalism after the collapse of socialism in the East, German unification, and the emergence of the neoliberal economic doctrine have all played important roles. The unrestricted mobility of financial capital in particular increases the competition among national regimes of capitalism.

What this actually boils down to is the competition between two ideal types of capitalist regimes, which still peacefully coexisted in the early 1980s: the 'Rhenish' managed capitalism, found foremost in Germany, and the 'Atlantic' market-oriented capitalism, flourishing primarily in the United States and Great Britain (Albert 1993).[1]

As Shonfield suggests in his analysis of the postwar period, the German model of 'organized' or *managed capitalism* is characterized by a high degree of collective functioning in the industrial and financial sectors (Shonfield 1965: 239–298).[2] A number of cartel-like arrangements and umbrella associations which often enjoy a semi-public status (so-called 'private interest governments'; Streeck / Schmitter 1985) help co-ordinate the processes of introducing change to the various economic sectors, both from the side of management and of labour. In the world of corporate finance, banks play the major role, not the capital market. Since German universal banks lend money, own stock and vote at shareholders' meetings, and have seats on the supervisory boards of their corporate clients, they are able to continually influence the management policy of these firms. Since, in turn, a great deal of information on corporate management policy is transmitted to the banks, they are more willing to support longer-term investment strategies by

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1 Rhodes / van Apeldoorn (1998) distinguish between 'market-oriented versus network-oriented' types of capitalism. For a further differentiation, see Schmidt (2000), who identifies 'state capitalism' as a third type and Fukuyama (1995), who characterizes the capitalist regime of Southeast Asia as 'family capitalism'.

2 Drawing on model characteristics introduced in the debate in economic sociology on the variations of national 'production regimes' (see Zysman 1983; Streeck 1997; Soskice 1999), this paper will focus on the aspects of the transformation of national models relevant to political science, such as changes in the realm of business, politics and the role and possible impact of governments.

granting comprehensive and low-interest credit (*patient capital*) and to bail their clients out of financial crisis. In this way, a company is integrated into a strong network of partners that largely protects each member firm from attempts at a 'hostile takeover' by other companies. Co-operative labour relations within the company are maintained by insuring employee rights of codetermination on the supervisory board. In stakeholder capitalism, company policy remains opaque to those on the outside, especially to small shareholders. Contributing to such opaqueness are the laws governing stock corporations, capital markets, and accounting standards, which allow market actors a great deal of discretion in determining the confidentiality of business information. These laws also enable management to calculate profits and losses over longer periods of time and to survive phases of severe losses better with the aid of tax-favoured reserves (*accounting principle of caution*). Such a strategy guarantees shareholders the payment of unchanged dividends over a period of time, even though the dividend may remain below the market value of the corporation's earnings and profits. The advantage of such a model is that it nurtures close and long-lasting relations, which serve as a type of infrastructure for the company and enable it to pursue managed strategies of crisis management. Since much responsibility rests on the shoulders of corporative entities such as cartels, associations and corporate management, the burden of responsibility on the state is significantly lightened. However, the state is incorporated into the system by being a partner on the national level and a member of numerous co-ordinating bodies.

The Anglo-Saxon model of *market-oriented capitalism* is characterized by more loosely coupled relations between industry, finance, and government. Within the industrial and financial sectors, associations act more like lobbies than like self-regulating institutions, and a strict antitrust policy prevents the creation, at least in the United States, of cartel-like structures of self-help in business. In the corporate finance system, banks do not play a major role. Instead they act more as buyers and sellers of securities, diversify their corporate stock holdings and tend to sell these during crises. Companies use the organized capital market first and foremost as a source to raise capital; they also diversify their ownership by being publicly traded. Rather than a strong network of stockholders and financial institutions, it is the market, meaning the stock market quotation of companies, which has the greatest influence on corporate management. Poor management is punished with falling stock prices and a drop in dividend payments, and the danger of an aggressive takeover increases very rapidly. Successful management rewards its shareholders with more frequent dividend payments during short-term periods of accrued profit. The advantage of a system based on short-term contacts is the ability to adapt immediately to changes on the market. Such a *shareholder value* orientation also tends to characterize labour relations. Incentives such as share-option programs and special performance-dependent bonuses help motivate top managers to pursue company interests aggressively. This investor-oriented system is supported, at least in the United States, by a rigid and formalized regulation of capital markets (in the area of corporate accounting standards and stock market regulation), which requires the public disclosure and reporting of information on the company and its market performance (*true and fair view principle*). This is enforced in part by law. Like the model of managed capitalism, this model of market-oriented capitalism does not place government at the centre of events. The state does, however, act as a liberal regulator that interprets its major function as being the guarantor of market transparency.

The peaceful coexistence of these different models of capitalism seems to be increasingly endangered. The deregulation of previously nationalized or at least nationally supervised economic sectors has increased the competition between national enterprises and thus the pressure to create more innovative products rapidly while reducing labour and capital costs. Decision-making processes that have traditionally relied internally on a consensus between management and labour and externally on co-ordination with associations, banks, and governmental representatives become costly when the quick responses are the international order of the day. The globalization of financial markets clears the way for the rapid and worldwide supply of capital and for a commercialization of the relations between creditors and debtors. Lastly, growing markets and increasing anonymity require the disclosure and formalization of the rules of conduct in the marketplace.

It is sometimes argued that the more product and capital markets are integrated, the more the model of managed capitalism will be deliberately coerced to adapt to its Anglo-Saxon counterpart. In this paper, the accuracy of this convergence thesis will be explored in the case of the German financial sector and its relations to business and the state. Until now, finance was always part of a national configuration of capitalism and thereby helped significantly to shape the mechanisms of a capitalist economy specific to a nation. However, in the German model an important transformation is taking place that reveals characteristics of the Anglo-Saxon model in the distribution of property rights, the nature of politics, the definition of polities and the creation of policy. At the same time, convergence of the models throughout the entire system has been prevented until now by institutional 'brakes' such as federal structures and by the consideration given those clientele, closely affiliated with party politics, who may be the losers in the modernization process.

The Old Model: Cartels, Corporatism and Self-Regulation[3]

Until now, the German banking sector has been dominated by the competition between three main types of institutions (*group competition*) which vary in their business strategy and corporate structure: the private commercial banks, the public or non-commercial savings banks (including the banks of each *Land*), and the credit co-operatives. The members of all three groups are universal banks, which are permitted to trade in securities and to deal in deposit-banking and lending. Unlike private commercial banks, the federally established savings banks and credit co-operatives are also charged with the task of pursuing goals that are good for the general welfare, in addition to those that are strictly good for their business. For the savings banks and *Länder* banks, one such goal is to ensure that all regions are sufficiently provided with financial services (*principle of territoriality*) and another is to use *Länder* banks to fulfil aims of industrial policy. As institutions of public law, the savings banks are supported in this business by their communities and the *Länder* banks by their respective state and municipal governments. They shoulder an unlimited liability for their banks by guaranteeing funds to cover unrecoverable capital (losses) and thereby insure the further existence of the banks (*Anstaltslast*). For credit co-operatives, the collective purpose of the institutions lies in the support of their members, who traditionally have been private customers and small skilled labour and retail businesses. Similar to the savings bank sector, the existence of each institution is guaranteed, since the members of the co-operative are personally liable for the organization in proportion to the number of shares each holds (*Nachschußpflicht*).

This limited degree of competition is also supported strongly by *umbrella associations, acting as 'private interest governments'* which can make binding commitments on behalf of the entire banking business. A glance at the history of the development of the German Savings Banks and Giro Association (*Deutscher Sparkassen- und Giroverband*, DSGV) and the Federal Association of Credit Co-operatives (*Bundesverband der Volks- und Raiffeisenbanken*, BVR) shows that these associations have nearly always assumed the task of auditing the books of their members as was stipulated in the Prussian auditing ordinance, or more specifically in the Co-operative Association Law. The umbrella organization for the private commercial banking business, the Federal Association of German Banks (*Bundesverband deutscher Banken*, BdB), also assumes certain 'public duties' because it runs a solidarity fund, financed by all member banks to protect customer deposits against bankruptcy and insolvency (deposit insurance). In practice, private banks are compelled to join the private banking association, because they are only permit-

3 To get a general idea of the German model, see Story / Walter (1997: 162–170).

ted to operate when they can prove their membership in a deposit insurance fund.[4]

Within the banking sector, we thus find an impressive degree of internal governance, the foremost purpose of which is to guarantee the continued existence of member firms and thereby stabilize the entire sector. Similar structures and functions can also be found in the relationship between *banks and industry*. The *Hausbank relationship*, so essential to the German model, is usually considered to have its roots in the financial participation of German banks during the industrialization that took place in the latter third of the nineteenth century. Alexander Gerschenkron (1962) has explained this quasi-symbiotic relationship between 'trust banks' and the business leaders of trade and industry, by pointing out the relative backwardness of a country that is considered to have been a latecomer to industrial development. Close relationships between banks and industry seemed to be a functional solution to the need to mobilize large sums of capital for investment. However, historians have challenged this functionalist perception by arguing that the power balance between banks and firms differed according to firm size, sector and region (Kocka 1978)[5]: Banks preferred large firms to small ones. They figured prominently in coal, steel, heavy machinery and the electrical industry, but never played a major role in textiles, machine tools or the chemical industry, whose rate of self-financing has traditionally been quite high. Up to 1900, the chemical industry was able to finance between one third and one half of its total expansion from operating surpluses (Kocka 1978: 565–566; Grant et al. 1988: 118–119). Moreover, as Herrigel (1996) has demonstrated, some German regions (e.g. Siegen, Baden-Württemberg) followed a decentralized industrialization pattern in which small- and medium-sized firms were dominant. Richard Deeg's work suggests (Deeg 2000) that until the 1920s, the financial needs of these regions were typically served by smaller savings and co-operative banks rather than the big universal banks.

While there is admittedly an empirical variety of German *Hausbank relationships*, the importance of close relations between 'big banks' and 'big business' in German industrial history cannot be overlooked. The three major universal banks (Disconto-Gesellschaft, Deutsche Bank, Dresdner Bank) were established by industrialists in order to raise capital by issuing and trading stock. By the same token, the banks bought shareholdings in multinational companies and later sought to monopolize the financial arrangements of 'their' industrial customers and to serve them in various ways 'from the cradle to the grave'. Industrial partners were committed to conduct all financial business only with them, including lending and giro transactions (Dyson 1986: 120–123; Gall 1995: 1–113). Banks also

4 More in Ronge (1979).

5 See for an overview of the more critical literature, Deeg (2000).

sought direct influence on all the important investment decisions of the companies which they helped to finance while, on the other hand, they were prepared to accept short-term financial losses in order to secure their long-term co-operation (Kocka 1978: 565–568).

Particularly during periods of crisis, the major private commercial banks used their close connections to industry to attain (additional) seats on the supervisory boards of their corporate clients, to increase their own shareholdings and, lastly, to procure more voting rights at the shareholders' meetings of these corporations. In addition, they held proxy voting power, which gave banks the right to vote on behalf of customers who had shares deposited with them. The cartels set up by these big banks in the steel and electronics industries in order to save Krupp (1966) and AEG-Telefunken (1979) have a nearly legendary status. In both cases, the respective *Hausbank* first organized a supportive banking consortium and additional loan guarantees from the federal and *Länder* governments. Then bank representatives assumed seats on the supervisory boards of these companies in order to better supervise the rescue operation.[6]

At the same time that German universal banks were emerging and becoming closely integrated with industry, the foundations of German corporate law were being laid. The salient features of this body of law were, firstly, the extensive autonomy granted corporate boards with regard to the disclosure of company information and, secondly, the control of company policy given to insider networks. In 1870, on the eve of the foreseeable period of rapid industrial expansion (*Gründerjahre*), the mandatory licensing of corporations was done away with and the German Commercial Code of 1861 became the framework for company founders. In keeping with the common business practices of the time, entrepreneurs were simply obliged to show 'adequate and orderly bookkeeping' as proof that they were upholding the principle of 'commercial prudence'. Statutory disclosure regulations governing the issuing of equities did not exist. In the wake of the crisis that followed this boom and of innumerable bankruptcies of stock companies, the state turned over its role as the formal supervisory agent to supervisory boards in 1884, which were responsible for the appointment and supervision of a company's board of directors and for approving certain business decisions. Such supervisory boards represented the most important groups of shareholders, most of which were banks, the family owners or employees of the company (Tilly 1999: 139). In the 1950s, labour became part of the stakeholder network that su-

6 As a result of this strategy, big banks controlled a high percentage of industrial holdings and voting rights: In 1980, the Dresdner Bank held more than 25 percent of the shares of 15 companies. According to the report issued in 1976 by the commission on monopolies, banks held nearly 15 percent of all board seats in the 100 largest companies and the chairmanship in 31 cases (Dyson 1986: 130).

pervised the work of the company's management. In coal, iron, and steel companies with more than 1,000 employees, supervisory boards were organized on a model of parity codetermination with representatives from the unions and shareholders' groups; in 1976, this principle was extended in the Codetermination Law to include all companies with more than 2,000 employees.

In a structural model that is based on a pronounced degree of self-regulation by banks, industry, and labour, the state does not play a major role. The autonomy of the German Federal Bank has been seen as one of the foremost factors in hindering the state from dictating monetary policy (Hall 1986). But the state is involved in making managed capitalism work, sometimes indirectly and sometimes decisively. For one, the state provides the banking sector with the necessary autonomy to regulate itself by granting banking associations the status of public institutions, implicitly committing them to act in the public interest. For another, the state codifies into law collectively negotiated settlements, such as the capital adequacy standards set by the banking associations, and makes these compulsory for all sectors of the market. As a partner in corporatist alliances, the state invests resources and thereby compensates its partners for concessions made, which in turn helps produce agreements.

Overall, the advantage of managed capitalism is that it combines stability with social balance: Risks are internalized through collective self-help, corporate decisions are controlled by an insider network, losers in the structural processes of modernization are compensated. However, a considerable disadvantage of the model is that the game plan of co-operation is devised by the insiders and remains obscure for outsiders, including small shareholders.

A New Framework: Globalization, Europeanization and the Impact on Germany

In the 1970s, after the Bretton Woods system fell apart and a transition to flexible exchange rates was made, an international trend to disassemble national controls over capital movement began to emerge. Governments permitted the trade of financial products and lowered the barriers for membership of foreigners on the domestic stock exchanges. The push to turn much of Europe into one large domestic market forced the integration of national financial markets beginning in the mid-1980s. Thanks to such a 'European passport', banks, stock exchanges, stockbrokers and security brokerages were able to offer their services throughout Europe as long as they upheld the minimum standards of capital adequacy and investor protection. The project to unify Europe monetarily reduces the profit margin in foreign exchange trading and pressures national financial markets to become more competitive. A European antitrust policy, endowed with special powers by the European Commission, is being pushed ahead to tackle barriers blocking further market integration.

Since the 1980s, a fundamental structural change has become evident: the business of issuing and trading securities has become much more attractive than lending money. For large creditworthy firms in particular, it is often cheaper to acquire capital on international markets by issuing shares or bonds than to seek loans from their *Hausbank* ('securitization'; OECD 1995). Banks are being sidestepped by their former customers as the classic financial intermediary ('disintermediation'), leaving the banks to get more involved in the lucrative business of securities trading. Institutional investors have experienced a growth spurt in the last 15 years, especially in the United States and Great Britain, that has made them major contenders in security markets internationally. Because they act as shareholders in large companies and as security buyers, these insurance companies, pension funds, and investment funds have been courted by banks and big business. Since institutional investors tend to diversify their portfolios internationally and operate with large blocks of the most liquid shares, they are in an excellent position to pursue their own interests by playing national financial centres, financial brokers, and capital-seeking companies off against one another.

While the market is being expanded, efforts are also being made politically to adapt the legal framework of the financial business and corporate governance to international standards. The European Commission envisions an integrated European capital market that also promotes investor protection by creating transparency in capital market transactions and in the business affairs of companies listed on the stock exchange. All the same, the initial steps in starting the dynamic pace of Europeanization were the individual national strides toward harmonization: In 1986 many countries, such as Great Britain, France, Spain, and Italy, began codifying and formalizing regulations pertaining to investor protection while establishing and expanding governmental supervision of the organized capital market. The motor driving this process has been fuelled by the United States, where the regulatory authority for the national capital market (*Securities and Exchange Commission, SEC*) has dedicated itself to the 'mission' of protecting investors. Companies wanting to be listed on an American stock exchange must guarantee that their accounting is 'transparent', in an American sense of the term, so that immediate transactions involving the capital market can be better monitored. On the international level, the SEC has successfully blocked any attempt by international 'regimes' to introduce standards of capital market regulation[7] that appear to

7 These include the IOSCO (International Organization of Securities Commissions) and the IASC (International Accounting Standards Setting Committee). Whereas the

threaten American interests. On the European level, the process of adapting to the American standards was completed for all practical purposes with the EU directives on 'insider trading' (89 / 582 / EEC, 13 November 1989) and on 'investment services' (93 / 227 / EEC, 10 May 1993). For the first time, insider-trading was legally prohibited and a network of domestic oversight bodies was established to insure international co-operation in regulating capital markets.

In the mid-1980s, banks, big business, and even German governmental authorities found themselves forced to take into consideration the needs of (foreign) institutional investors, their new target group, when shaping their own company policy or when restructuring the domestic financial marketplace. Important elements of the older German model threatened to impede considerably the competitiveness of the German economy. One such element in corporate law was the importance given the rules – self-made and self-monitored by an insider network – that regulated the conduct of the providers of financial services in capital markets or the conduct of company management toward investors. Foreign institutional investors and the SEC criticized the existing system of informal self-regulation for its lack of transparency and accountability. In addition, the SEC prohibited the sale of new stock exchange products in America by arguing that these came from a market operating with standards lower than its own (Lütz 1998). American authorities and investors hold a similar position with regard to the German, i.e. the Continental model of accounting standards, which gives management more leeway to calculate and report profits and losses over longer periods. So far, the SEC has recognized neither the German Commercial Code (*Handelsgesetzbuch*, HGB) nor the internationally co-ordinated *International Accounting Standards* (IAS) as a ticket to the American capital market. Instead, foreign firms wishing to be listed on the American stock exchange are required to follow American standards (*General Accepted Accounting Principles*, GAAP).[8]

There was a time in Germany when close relationships within industry, but also between banks and industry were considered to be the key to successfully managing a business crisis or preventing 'hostile takeovers'. Now, foreign investors view 'Germany, Inc.' as a handicap to investment. Cases such as the bankruptcy of Schneider Enterprises and the crises of the Metallgesellschaft or recently the Holzmann company made the banks look like clueless creditors and the supervi-

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IOSCO is dedicated to negotiating norms in the broadest sense for securities, representatives within the IASC attempt to agree on an international accounting standard.

8 On the political struggles between Europe and the United States with regard to global accounting standards, see Financial Times, 25 March 1999, p. 6, Handelsblatt, 9/10 April 1999, p. 18, Financial Times, 19 November 1999, p. 5 and on the perceived 'disadvantages' of the German HGB compared with US GAAP, see Financial Times Deutschland, 21 February, 2000, p. XIV.

sory boards like incompetent ‘closed shops’. International alliances of institutional investors have formulated principles for ‘good corporate governance’ that call for a greater distance of supervisory boards to their corporations and a limitation on the number of seats in Germany.[9] For the big banks, which are engaged increasingly in investment banking and act as security traders and business consultants, it could become disadvantageous to own large amounts of industrial stock and to hold seats on a number of supervisory boards. Many companies do not even want to be advised by a bank that owns stock in their competitor or holds a seat on its supervisory board.[10]

Pressure has been mounting since the mid-1980s not only on private market investors but also on the state to make the domestic market an internationally competitive ‘financial centre’. The complaint made by foreign investors that German corporate law lacked investor protection measures was addressed to the Federal Ministries for Justice (BMJ) and Finance (BMF), which are responsible for all issues regarding capital markets, including corporate and stock exchange law. On the European level, both ministries had long attempted to defend traditional Continental accounting practices or, more specifically, the informal self-regulation of capital markets. With regard to accounting standards, it was clear by 1990 at the latest that the strategy had failed when the European Commission ceased to issue further directives and turned the project of harmonization over to the International Accounting Standards Committee (IASC). This body consists not only of representatives from selected European states and Japan, India, Malaysia, Mexico and South Africa, but also of delegates primarily from countries with a tradition in Anglo-American accounting (such as the United States, Great Britain, Australia, Canada, and New Zealand), who often cast the decisive votes in important decisions.[11] Still, the German finance ministry attempted to prevent passage of the insider-trading directive in the Council of Ministers. The Germans found themselves isolated on this issue and faced with the possibility of being overridden by a qualified majority of member states. Moreover, they discovered that Germany’s reluctance to establish a governmental authority to monitor the national capital market was steadily turning into a obstacle for international cooperation (Lütz 1998).

9 Financial Times, 6 April, 1998, p. 6.
10 Financial Times, 3 September, 1997, p. 15.
11 On IASC, see http://www.iasc.org.uk.

On the Road to a New Model? Commercialization, Pluralization and Regulation

The *relationship between the three German banking groups,* which had maintained a commercial form of peaceful coexistence until now, is becoming more and more tense. The trade associations of both the private and public banking sectors no longer hesitate to battle out their differences in the press.[12] Structural changes in the international financial markets and the plurality of interests arising from these changes, especially among private and public banks, have turned this latent conflict into open hostility. As the profit margins dwindle in the classic lending and savings deposit business, savings banks and credit co-operatives are beginning to consolidate their operations, a move that places the markedly decentralized nature of both banking groups in question. So far, not one credit co-operative bank has been closed; instead, problematic situations have been corrected in the time-tested manner of fusing banks under the supervision of the umbrella association.

In the savings bank sector, pressures to modernize the decentralized sectoral structure spurred efforts to centralize product development and the settlement of equity trading activities or to establish a centralized online brokerage service. Also, regional governments like Baden-Württemberg and Saxony have put political pressure on their local governments, regional savings bank associations and regional public sector banks (*Landesbanken*) to join forces. The state of Saxony, in particular, has pushed ahead the idea of a 'Saxony Holding', including the state's *Landesbank,* the '*Sächsische Aufbaubank*' (another large state-owned bank), and 22 smaller savings banks. Critics, such as regional savings associations and trade unions, argue that the plan challenges the principle of territoriality and that it will lead to massive job losses among regional savings banks.[13]

This strong resistance indicates that in this sector, concentration processes are considerably buffered by different veto players expecting to lose their autonomy in the face of further consolidation. This argument is also true for regional governments themselves. On the one hand, states are pushing the centralization of the public banking structure on their own territories; on the other hand, they are still rejecting the idea of merging all 13 regional public sector banks or of incorporating them in a holding structure.[14]

12 See for instance, Frankfurter Allgemeine Zeitung, 5 August 1999, p. 25, 6 August 1999, p. 25.

13 Frankfurter Allgemeine Zeitung, 1 December 1999, pp. W 1–2.

14 Financial Times Deutschland, 14 March 2000, p. 1.

The future structure and business strategy of the saving banks association, however, rests upon the decision whether or not to retain the state-guaranteed status enjoyed by such banks, which has become unique in Europe. Should the savings bank sector be privatized, the consequence would be an acceleration of the concentration process by merging savings banks and credit co-operatives or by merging larger savings banks and private banks. So far, the federal government and the majority of the German *Länder* have opted to retain the public banking system. Opponents of this system, however, are resorting more and more to European anti-subsidy laws in order to question its legitimacy. In 1994, the German association of private banks, in co-operation with its counterparts in Great Britain and France, filed a formal objection with the European Commission that accused the government of North Rhine-Westphalia of illegally subsidizing the Westdeutsche Landesbank (WestLB, West German State Bank). In 1992, the government had offered the bank a capital infusion in the form of publicly owned housing assets at the rock-bottom interest rate of 0.6 percent. The private banks argue that their public competitors enjoy better ratings, and thus significant advantages in refinancing thanks to state guarantees. In July 1999, the EU Commission ruled that the WestLB had to repay the government of North Rhine-Westphalia subsidies amounting to nearly DM 1.6 billion. This ruling was a signal to other German *Länder* governments, in which similar practices were common. In September 1999, the Commission asked the German government for information about six other *Landesbanken* that were involved in transactions comparable to the WestLB.[15] Similarly, the European Commission is examining whether the special feature of German banking in which communal and regional governments back up their public sector banks with unlimited liability guarantees must be considered an unacceptable state subsidy.[16] Moreover, the European Banking Federation, the association of private banks in Europe, has prepared a formal complaint to the Commission about the controversial state guarantees for the *Landesbanken*, which it says discriminate against the private banks.[17]

So far, the WestLB has not paid back the subsidy. The state government of North Rhine-Westphalia does not want the money back and has instead proposed increasing its 43 percent equity stake in the bank rather than receiving the payment in cash. Concluding that this would do nothing to eliminate the cost advantages the WestLB had gained when it received the aid, the Commission rejected the proposal. In March 2000 the conflict escalated even further when German regional leaders from Bavaria, Hesse, Bremen and Thuringia threatened to block the EU's enlargement process in the *Bundesrat*, the German upper house, if Brus-

15 Financial Times, 25 November 1999, p. 2.
16 Handelsblatt, 7/8 May 1999 p. 2.
17 Financial Times, 2 December 1999, p. 16.

sels did not leave the *Landesbanken* alone.[18] The Commission has threatened to take Germany to the European court if it presents no new proposals as to how the subsidies should be paid back. The federal government however, is seeking a compromise with Brussels on the state subsidies issue, because it does not want to impede the process of European integration.[19]

These examples show how sensitive the private banking sector is to practices that allegedly place it at a disadvantage when competing on European and even world markets. Big private commercial banks are concentrating their business in the commission-earning business of securities trading. In the last couple of years, they pursued an aggressive merger strategy abroad in order to acquire the know-how of British and American investment banks. The Deutsche Bank merged first with Morgan Grenfell and in 1998 with Bankers Trust, while the Dresdner Bank joined with Kleinwort Benson. The failed merger of the former rivals Deutsche and Dresdner Bank, however, does indicate a qualitative shift with regard to the upcoming structural changes on international banking markets. The merger would have suggested an end to the old European universal bank model. The new group would have largely abandoned retail banking and instead focused on more profitable areas such as private banking for wealthy clients, asset management and especially corporate and investment banking.[20]

Domestically, the big banks are deliberately *disengaging themselves from industry* (Esser 1990; Edwards / Fischer 1994; Schröder 1996; Deeg 1999) in an effort to improve their international reputation as security traders and business consultants. However, the private banking sector has become increasingly reluctant to enter risky and therefore expensive rescue operations of all types, which was particularly evident during the process of German unification. To many observers, German unification appeared to prove that the co-operative model of crisis management works and could survive; the contributions of the state, industry, labour and banks towards the rebuilding of East Germany were negotiated and then legally stipulated within the framework of the Solidarity Pact (Sally / Webber 1994). Under considerable pressure from the federal government, from the Treuhand Agency, and even from the public, representatives of the banking associations finally announced in 1993 that they would support the Treuhand Agency with a billion marks to aid in the process of privatization. By mid-1995, the banks declared that they had already spent their 'banking billions'. At that point they had invested DM 340 million in 13 firms, and the savings bank sector had invested a sum of DM 412 million (Deeg 1999: 195). Banks reacted differently than they once

18 Institutional reforms that are linked with the EU's enlargement process would need German upper house ratification.

19 Financial Times, 3 March 2000, p. 3.

20 Financial Times, 10 March 2000, p. 19, Financial Times, 14 March 2000, p. 15.

had when a sector of the economy needed to be rescued in a crisis: they used their investment banking capacities and/or subsidiaries to facilitate the privatization of Treuhand firms. For example, Deutsche Bank used its subsidiary Morgan Grenfell and the Roland Berger business consulting firm to advise the Treuhand Agency in the selling of its companies, to counsel potential buyers of Treuhand enterprises, and to aid managers of privatized businesses.[21]

In the course of unification, the German banks showed little interest in buying shares in privatized enterprises. This corresponds with an overall strategy of the big banks to gradually reduce the underperforming shares in their portfolios, although an active management of the stakes has been blocked by the approximately 50 percent tax payable on capital gains. The Deutsche Bank in particular has reduced the number of its large industrial holdings (25 percent or more) and tends to limit many of its holdings to less than ten percent (Deeg 1993: 158). The Institute for Economic Research (IFO) has estimated that merely 10 percent of the domestically owned shareholdings in late 1996 were in the hands of the banks and that shareholdings only comprised two percent of all banking assets (IFO 1997: 10).[22]

The accumulation of seats held by banks on supervisory boards no longer seems to be an element of a managed model of capitalism, as it once was. Whereas in 1974 private banks held over 20 percent of the supervisory board seats in the 100 largest companies, by 1993 this percentage had dropped to a mere 6.3 percent (IFO 1997: 11).[23] In addition, Krupp's attempt at a hostile takeover of its competitor Thyssen in 1997 revealed that structural linkages could be used under new conditions to break away from earlier principles of consensus. For example, the groundwork for this takeover attempt was laid by the investment bank subsidiaries (Morgan Grenfell and Kleinwort Benson) of the *Hausbank* that sat on the supervisory boards of both Krupp and Thyssen. Thus, for the first time, German banks openly sided with the 'hostile' attacker, whereas earlier they had defended German stock companies against an unwanted third party.[24]

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21 Deeg (1999: 191–192). Yet, the Treuhand Agency did not turn to the banks in seeking help for its own refinancing. Instead it issued medium- and long-term bonds and debentures (THA bonds), meaning it turned to international capital markets to raise the funds it needed (Czada 1996: 167).

22 Data for the period of 1976 to 1986 indicate that the number of firms in which banks held at least ten percent of shares declined from 129 to 86 (Camman/Arnold 1987: 120–123).

23 Similar data in Jackson (1999: 24).

24 Frankfurter Allgemeine Zeitung, 19 March 1997, p. 15.

Big business is also relaxing its relationship to the banking sector.[25] In recent years, it has expanded its degree of self-finance significantly as opposed to turning to the banks for loans. In the course of the current wave of transborder acquisitions and mergers, the international capital market is developing into an important forum for redefining ownership structures and rules of conduct. The successful takeover of Mannesmann by its British rival Vodafone AirTouch was not only the world's largest hostile bid ever ($128 billion), but also exemplifies that German companies are possible targets for hostile takeovers because their stock prices are estimated to be undervalued in light of the undisclosed reserves that they have accumulated. The bid battle was run according to 'Anglo-Saxon market logic' since Mannesmann's eventual acceptance of the deal was largely due to pressure from shareholders, i.e. institutional investors.

Deals such as the merger of DaimlerChrysler and the consolidations of Degussa and Hüls and of Hoechst and Rhône-Poulenc are staged by investment banks, which then establish contacts to investors. Currently, foreign investors own between 40 and 70 percent of the shares in 10 of the largest 100 German companies (60–70 percent of shares in the former Mannesmann AG and in the Metallgesellschaft compared, for example, with 44 percent of Veba).[26]

These globally oriented companies claim to be the vanguard of a corporate policy that includes shareholder value-principles such as higher dividend payments and balance sheet disclosure. Companies like Hoechst, Schering, BASF or SAP plan in the future to increase the use of Anglo-Saxon instruments such as share-buy-back programs. Another important element of this new corporate policy is to nurture relations to investors. The *Deutscher Investor Relations Kreis, e.V.* (DIRK) is an organization founded in 1990 that now comprises of 110 companies quoted on the exchange and is dedicated to sharing experiences in dealing with investors both at home and abroad.

As corporate financing becomes internationalized, more German firms are being listed on foreign, usually American, stock exchanges. For a long time, German companies were deterred from entering the American capital market because the SEC would not recognize German or even the internationally established standards of accounting (IAS). In 1993, Daimler-Benz became the first company to abandon the domestic camp and to switch its accounting practices to the American GAAP standards in order to be listed on the New York Stock Exchange – a step that came under heavy fire in Germany and weakened the German position in the organizations upholding the international standards of accounting. To date,

25 For more on the current debate on German corporate governance, see Faust (1999).

26 See the database of the Max Planck Institute for the Study of Societies on the internationalization of the 100 largest German companies (Hassel et al. 2000: 19).

Deutsche Telekom, Hoechst, SAP, VEBA and SGL Carbon AG have followed the example of Daimler-Benz.[27]

The fact that a certain sector of the business world, including the banking business, is gearing itself to capital markets worldwide indicates that interests are becoming more diversified. Whereas the majority of small and mid-sized companies still prefer to maintain the classic *Hausbank* relationship with saving banks and credit co-operatives[28] and appear as yet to be unruffled by the discussion concerning the adoption of Anglo-Saxon standards of accounting, the globally oriented segment of the corporate world has become part of a new *capital-market-oriented policy community*. This community no longer resembles earlier cartels or business associations. It includes such representatives of investors' interests as the lobbies of companies listed on the exchange that advertise stocks and offer advanced training in stock market investing, shareholder associations,[29] and the Association of Investment Funds. New professional groups have also developed, such as the organizations for financial analysts and for certified and chartered accountants, whose expertise in working with new financial products, customers, and rules is increasingly in demand.

Had the *state* not paved the way, none of the changes described above would have been possible. In the older model, the state was more like a partner in a corporatist alliance who approved and codified negotiated solutions. Now it acts as a *benefactor, regulator, and lobbyist* of domestic (financial) markets. Since the early 1980s, the state has generated an unprecedented thrust in legislative activity aimed at promoting Germany as a financial centre. In all, seven laws have been passed, in part to meet European guidelines but more notably to help remove gradually the barriers blocking the use of the domestic capital market and the trade of new financial products. In 1989, the first revision of the German Stock Exchange Law in nearly a century created the legal framework for establishing the German Futures Exchange (*Deutsche Terminbörse*, DTB), in which a number of foreign financial products such as options, futures, and swaps could be traded. Between 1990 and 1998, three laws promoting financial markets were passed, of which the third alone contained 100 different measures. Among the most important measures was the admission, in 1994, of money market funds and, in 1998, of a special retirement savings option that can be organized as a mutual fund. Nev-

27 In March 2000, 25 German firms were listed on foreign stock exchanges and 11 companies were following US GAAP accounting principles (Hassel et al. 2000: 20).

28 According to recent data of the German Bundesbank, small and medium-sized businesses have become even more dependent on bank loans (Deutsche Bundesbank 2000: 40).

29 E.g. the *Verband der Kleinaktionäre* (VdK) and the *Deutsche Schutzvereinigung für Wertpapierbesitz e.V.* (DSW).

ertheless, American-style, tax-favoured pension funds have not yet been introduced because they are stiffly opposed by the German insurance business. In the field of equity trading, the repurchase of a maximum of ten percent of a company's own stock was first approved in the 1998 Control and Transparency Act (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*, KonTraG).

The key factor leading to the restructuring of the German model was that the steps to liberalize the financial market were accompanied by attempts to reregulate its framework. Reforms, first in stock exchange regulations and later in corporate law, sought to make the conduct of market participants and the business transactions of companies listed on the exchange more transparent. The Second Law for the Promotion of the German Financial Market, passed in 1994, proved to be the turning point in the history of the German stock exchange because, following a bitter battle with the *Länder*, the federal government assumed responsibility for monitoring the stock exchange for the first time, and a supervisory agency for security trading (*Bundesaufsichtsamt für den Wertpapierhandel*, BeWe) was established under the jurisdiction of the Federal Ministry of Finance. Two of the tasks given this agency were to crack down on insider trading, which had finally been outlawed, and to insure that banks and investment businesses complied with the new 'rules of conduct.'[30]

Additional reforms concentrated on corporate law. With the passage of the above-mentioned *KonTraG* in March 1998, the proxy voting rights of the banks were restricted: If a bank holds more than five percent of a company's stock, the bank may no longer automatically assume the proxy voting rights of its investment customers. Furthermore, banks and businesses must disclose holdings of over five percent. The effort to reduce the number of supervisory board seats from 20 to 12 failed to succeed because of opposition from the unions, who feared losing their rights of codetermination, and from the Ministry of Labour. Against the initial plans of the Justice Ministry, the VW-law also remained intact, meaning that no other shareholder was allowed to own more than 20 percent of the voting rights except the government of Lower Saxony and that the government, as a shareholder, could not be overridden.

The Justice Ministry was successful, however, in reforming the accounting standards with the passage of a law facilitating the raising of capital (*Kapitalaufnahmeerleichterungsgesetz*, KapAEG) in April 1998. German companies listed on the exchange are now allowed to issue consolidated financial statements that are calculated on the basis of internationally accepted accounting standards (IAS or US-GAAP). They are exempted from filing the type of annual report required by

30 For more on centralization processes in systems of financial federalism, see Deeg / Lütz (2000).

German law. Thus, lawmakers were merely authorizing the practice of using American accounting standards that German companies had already actually adopted upon entering the New York Stock Exchange. In March 1998, a German Accounting Standards Committee (*Deutsches Rechnungslegungs Standards Committee*, DRSC) was established to work out accounting guidelines and to represent Germany in international organizations.[31]

In December 1999, the Ministry of Finance unexpectedly announced that it would abolish the taxes on capital gains from selling equity stakes, held by one quoted company in another, as of January 2001. In theory, this move would allow companies to divest free of tax the big shareholdings built up in rivals and industrial groups. However, it seems unlikely that the complex web of holdings between well-known firms and banks would immediately unravel, since many of the stakes are so big that a quick sale would be impossible. Nevertheless, the measure is seen as an important step toward a gradual whittling down of stakes which are considered non-essential.[32] The ministry's plan now faces mounting opposition both from the Christian Democrats and some members of the ruling Social Democratic Party. The CDU attacked the reform as unfairly benefiting large, publicly listed groups as it only applies to joint stock and limited companies, while the Social Democratic state governments believe the decision is overly generous to big business and risks forgoing valuable tax revenues at a time of austerity in state spending. It seems likely that the Federal Ministry of Finance will give in to the opposition of the regional governments since the plan is part of a broader tax reform which needs ratification of the German upper house.[33]

Finally, an expert commission chaired by Chancellor Schröder is drawing up plans to replace Germany's voluntary takeover code with a new takeover law by the end of 2000. The expert group was set up to examine the consequences of Vodafone's successful bid for Mannesmann. The upcoming law is supposed to include clear rules about the level of shareholdings above which a general offer must be made for all of the company's shares and provisions to protect minority shareholders by ensuring that they be treated equally – in terms of price and information.[34]

This burst of activity shows that the state is using its legal and regulatory resources to promote Germany as a financial centre. On the European and global

31 The committee includes representatives from the Ministry of Justice, private banks and, in particular, professional organizations such as the one representing the accountants. Frankfurter Allgemeine Zeitung, 30 March 1998, p. 16.

32 Financial Times, 24/25 December 1999, p. 3.

33 Handelsblatt, 8 February 2000, p. 3; Financial Times, 17 March 2000, p. 1.

34 Financial Times, 13 March 2000, p. 2; The Economist, 18 December 1999, p. 136.

levels, ministries and regulatory agencies act as *lobbyists* of their country's own banks and businesses. The fact that German regulatory traditions are exposed to considerable pressure to conform to the demands of these new market conditions is illustrated by the spread of principally American-like standards of transparency in laws governing capital markets, stock exchanges, and corporate business, and by the resulting circumvention of international efforts to negotiate standards.

Conclusion: Convergence or the 'Alternative Path'?

German finance, possibly more so than other economic sectors or political arenas, is under increasing pressure to structurally change older models of distributing property rights, conducting politics, and constituting policy. Gone or at least far less prevalent is the institutional equilibrium between banks, industry, and the state, which had been maintained by a system of cartels, corporatist self-regulation, and informal norms. Instead, the spectrum of those involved is widening substantially, interests among industry and banks are becoming more heterogeneous and competition between the three major bank groups is increasing. This trend toward increased commercialization also influences the entire relationship between banks and industry. In the process of reshaping corporate governance, the interests of foreign investors and small shareholders are being given more weight, whereas the power over company policy held by insider networks is considered less and less legitimate. More than ever, the state is acting both at home and abroad as benefactor, regulator, and lobbyist for domestic financial centres and is using its resources to promote competition. The laws passed and regulations enacted to establish the national system reflect the new overriding objective of every step toward transformation – to make market participants and market conduct more *transparent*.

Does this mean that German managed capitalism is unilaterally adapting to an Anglo-Saxon market-oriented capitalism? Indeed, on the one hand, there is good reason to assume that German finance will take further steps down the road to a more market-friendly model. Investment funds will continue to gain ground in the business of private investment for lack of an attractive alternative. Because of the financial problems facing the social insurance system, private and company pension funds will become at the least a supplementary source of old age security for some time in the German system of social insurance. No one can yet predict whether this will develop into a 'grey capitalism' (Blackburn 1999) based on pension funds as is known in Great Britain. In any case, as investment funds gain a stronger foothold in Germany, a lobby of institutional investors increasingly in-dependent of the banks will exercise more and more influence on the financial sector and will demand from politicians more extensive reform in the areas of corporate law and corporate governance.

Nevertheless, we should not overestimate the extent of the transformation that has already taken place.[35] So far, only the top tier of the globally oriented segment of the banking and commercial world has been affected. In the more nationally oriented segment of the economy where the clientele consists of small and medium-sized businesses, banks and industry remain closely meshed, capitalism continues to be managed through various avenues by organized trade interests, and corporate governance still exists in forms that permit a great deal of corporate autonomy. Examples of this are found at the regional level in the continuation of certain types of industrial policy,[36] in the co-ordinated regulation of equity standards by the major banking associations (Lütz 1999), or in the maintenance of collective deposit insurance funds. Furthermore, alliances between the federal government, management, and labour are apparently still possible, as is illustrated by the Solidarity Pact that evolved from the process of German unification. However, the major commercial banks are not included in these networks.[37] Over time it will become clear how the national model is internally handling the *fissure* that has resulted from worldwide developments. The increasing concentration of businesses through merger and consolidation within the sector of small-business-oriented savings banks and co-operatives indicates that this clientele is also being forced by the processes of globalization to accept expensive changes that possibly even threaten its chances for economic survival.

The transformation that has taken place so far also demonstrates how effectively institutional structures can halt externally induced processes of adaptation. By far the most powerful check on the push toward the privatization and concentration in the public banking sector has been German federalism. The unwillingness of the regional governments to merge or even privatize their public sector banks and, for example, the opposition of the government of Lower Saxony to the pro-

35 Particularly since we did not discuss whether the Anglo-Saxon model is changing, too.

36 … which are becoming increasingly difficult to maintain in light of the EU ban on subsidies.

37 The spectacular bailout of the Holzmann company by banks, labour and, most importantly, the state does not reverse this overall trend. The banks would not have saved the firm from insolvency had the Chancellor himself not subsidized the rescue operation with state guarantees. Moreover, banks were under pressure from their own institutional investors to justify this bailout. On the European level, the operation was criticized for undermining European competition policy and burdening the stability of the Euro (see Financial Times, 25 November 1999, p. 10, Financial Times, 3 December 1999, p. 1).

posed revocation of its majority voting rights at VW illustrate the zealous effort the *Länder* are willing to make in order to retain, if at all possible, their influence on regional banks and businesses, so as better to implement their industrial policy. With regard to corporate law reform, the unions, backed by the Labour Ministry, have proved to be a formidable lobby, one strong enough to block the planned reduction of the number of supervisory board seats in companies with co-determination.[38]

What does all this show us? The German model of managed capitalism will not develop into the twin of its market-oriented counterpart. What is far more likely is that market-oriented elements will be built into the system and therefore a new '*hybrid*' model will evolve. Whether this new system will finally combine the virtues of the German and the Anglo-Saxon model – social balance and flexibility – remains to be seen.

38 See Vitols (1999) for a similar evaluation regarding the winners and losers of this sectoral restructuring.

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